IS ALL SO WELL WITH THE ECONOMY AND WITH THE RURAL POOR?

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"...I realized that the fellaheen saw the material circumstances of their lives in exactly the same way that a university economist would: as a situation that was shamefully anachronistic, a warp upon time. I understood that the relationships of their everyday lives was never innocent of the knowledge that there were other places, other countries which did not have mud-walled houses and cattle-drawn ploughs".

Amitav Ghosh, *In An Antique Land*, Ravi Dayal, New Delhi (1992): p.200

Visitors to Sri Lanka must find it hard to reconcile conflicting images in the media about what is happening. They find confident assertions that the East Asian crisis has effectively missed Sri Lanka, that foreign investment is flowing, the economy is buoyant and the war is almost over. And they see the stock market at an all-time low, tea prices dipping and many export industries in trouble. There are headline reports of heavy war casualties, mass desertions from the armed forces, youth unemployment and an apparent deterioration of law and order. Casual conversations reveal widespread disenchantment with mainstream politics.

The picture is baffling even to residents. Looking at the economy, it is a fact that Sri Lanka appears to have escaped unscathed from the collapse in East and South-East Asia. It avoided contagion (there was no panic or crash), GDP reportedly grew in 1997 by 6.4% and several other indicators suggest a healthy economy.[1] But they do not tell the whole story. For that it is necessary to delve deeper, to look at the processes behind them, to place them in today's global economic setting, and to interpret them in their social and political context. Such an analysis suggests that the economy is vulnerable, and that a period of considerable volatility may lie ahead.

A scenario where, over the next 1-2 years, a confluence of adverse international and domestic developments could undermine the bases of social and political stability in explosive fashion is not at all improbable. If current widespread concerns about a serious global economic downturn materialise, it will be impossible for Sri Lanka — a highly trade dependent economy — to be unaffected, even if it has thus far escaped contagion from the East Asian crisis. An economy running out of steam in a deteriorating international environment will threaten rising unemployment and increasing poverty. This could occur at a time of mounting disillusionment with mainstream political leadership arising from the failure to tackle corruption, to end the war, to dynamise the economy or to ensure a more equitable distribution, and rising concerns with the scale of human suffering from the war.

In this paper, we focus on what has happened in the area of poverty and equality in recent years, and discuss the potential impact of an economic downturn. In the first section we examine the policy context and recent trends, and the factors which have prevented a serious deterioration in poverty. Then we ask how the poor will be affected by an economic downturn and why a scenario of social explosion cannot be entirely ruled out.

Inequality and Poverty

Inequality and poverty have always been potent political issues in Sri Lanka, and there has been much debate about distribution, growth and welfare in Sri Lankan society. With the election of the People's Alliance government in August 1994, expectations were high. Not only was it perceived as left-of-centre and therefore sensitive to distributional issues, but it was expected to end authoritarian rule, political intimidation and — most importantly — the war. The stage seemed set for a far more open and democratic phase in the country's development. Once in power and confronted with economic realities, it pragmatically decided to maintain the *status quo* with regard to economic policy, cementing a consensus amongst the major political parties in favour of a liberalised market economy. The focus of policy continued to be on export-led, urban-based manufacturing and services, with a safety net in the form of the Samurdhi Programme.

So, what has happened in the' nineties? Outside the war-affected areas, poverty appears to have been held in check and, in the view of some observers (the World Bank in particular) even reduced (World Bank 1995). The early 1990s were, in a sense, a period of relative prosperity. In the urban areas there was a surge in manufacturing, construction, trade and the service sectors. In the paddy-based rural sector real farm incomes declined, but poor households were bolstered by private transfers and remittances and by public anti-poverty programmes. Non-paddy rural areas were nearer to and better integrated into the Greater Colombo economy and they were also favoured by higher commodity prices —particularly for smallholder tea from late 1995.

But to get a better understanding of what has been really happening, it is also useful for a moment to stand back and to take a long-term view. Table 1 brings together the data on household income distribution in Sri Lanka from 1953 to 1996/97. For all the well-known limitations of the Gini coefficient[1a] as a measure of changes in distribution, what stands out is not the variation from one survey to another. It is that, apart from the 1973 figure (where the trend is probably correct but the extent of the improvement is believed to have been greatly exaggerated),[2] there has been a remarkable degree of stability — something also observed in many other Asian economies. A Gini fluctuating around 0.45 by $\pm$ 0.02 over fifty years cannot be said to express any significant changes. The same applies to the distribution of expenditure, though we have not repeated it here.

Table 1: Gini Coefficients for Income of Spending Units

1953	1963	1973	'78/79	'80/81	'81/82	'85/86	'86/87	'90/91	'96/97
0.46	0.45	0.35	0.44	0.43	0.45	0.46	0.46	0.47	0.45

1. Figures for 1980/81, 1985/86 and 1990/91 are from the Labour Force and Socio-Economic Survey of the Department of Census and Statistics and given in Nanayakkara (1994); other figures are from Consumer Finance and Socio-Economic Surveys of the Central Bank, given in Colombage (1998).
2. The 1996/97 figure is preliminary estimate.

More Recent Trends

Looking more narrowly, since the opening up of the economy, income distribution seems to have remained basically unchanged while average incomes have risen. Improvements were recorded on most social criteria (Central Bank 1998)—not surprising given a more than fourfold increase in real GDP per capita. There is some evidence that the income share of the bottom 40% deteriorated, but over the post-liberalisation period the changes have been marginal (Colombage 1998) and not enough to offset the impact of overall income growth.

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However, a point that is often missed is that, aggregated distributional data are really an inappropriate measure of the what is happening in a period of rapid economic reform because they underplay adjustments in long-term wealth (Jayasuriya and Dunham 1998). Within a fairly stable distribution of household income at national level, some people were gaining and others were losing, and these shifts in relative fortune were socially and politically significant.

So what form did they take? First, there was a quite dramatic widening of regional income disparities. The World Bank (1995:23) found that in 1990-91 - excluding the north and east (on which there was no data available) there was "only limited regional variation in poverty" . But differences between rural regions were not the critical issue. The pronounced Colombo bias in the location of investment, employment and income was more significant. In all cases, regional mean incomes as a percentage of that of Colombo municipality showed a marked decline (see Lakshman 1997: table 6.8). Inequality in the urban areas themselves also increased sharply in the 1990s (Nanayakkara 1994: table 16). Together, these data confirm more impressionistic evidence that in Sri Lanka (as in so many other countries) there has been a strong urban middle-class dynamics to the liberalisation process. And this rising prosperity of the urban rich must be contrasted with the other side of the coin: social marginalisation and the bereavement, mutilation and trauma of war has been a largely rural experience

The impact of economic liberalisation on non-metropolitan regions of the country has, in relative terms, been consistently negative. In the north and east (which has provided most support for the LTTE), mean incomes were almost on a par with those in Colombo in the early 1970s but had almost halved by the early 1980s. And, this would seem plausible. Trade liberalisation sharply reduced agricultural exports from the Jaffna peninsula to the Colombo market and, the area missed out on getting major projects (Lakshman 1997). More recent data is unavailable, but it can reasonably be assumed that, with the on-going war, the region has become far more impoverished, with large numbers of refugees rendered effectively destitute (*ibid.*:191). Nor is the example of the north and east so exceptional: expressed as a percentage of the mean income in Colombo, the decline in other regions since the early 1980s has not been significantly different.

Second, there seems to have been marked spatial differentiation within the rural periphery that is not captured by orthodox analyses based on administrative units. Poverty is unlikely to have declined much in the primarily rice-based parts of the country (Dunham and Edwards 1997). Since the mid-1980s, yields have stagnated, real paddy incomes in all but the best irrigated areas have declined, there was no noticeable movement into higher value crops, the growth of regular and remunerative off-farm employment in rural areas (relative to growth of the rural workforce) has been minor, and little rural-urban migration has occurred. Given access to basic welfare services, people have fallen back on a combination of family land, unpredictable and poorly-paid casual work and a range of non-traditional support systems. However, in the course of the liberalisation process, the nature of these survival systems has been changing. It is to this we turn next.

Changing Household Support Systems

The pre-1977 state played a prominent (if paternalistic), and relatively successful role in basic needs provision. However, after 1977, the imperatives of stabilisation and fiscal reform saw major changes in the overall welfare package, and cuts (and the sometimes perverse effects of 'better targeting') forced many people to rely on other sources of income. There is clear evidence that the transition was difficult (especially after the real value of food stamps was rapidly eroded by inflation). However, by-and-large, the transition was successfully negotiated. In this section we look at the support systems emerging. In the next section we ask if they are so secure.

Since the mid-1980s, the poor have benefited from both public and private transfers — to some extent from direct government transfers (under poverty alleviation programmes), but more importantly from injections into the rural economy from outside: from war (and security) related employment and migrant worker remittances (Dunham and Edwards 1997).[3] This has been particularly (though not only) true of the rice-based areas. Table 2 extends the analysis to 1997, adopting a conservative scenario on overseas remittances. The figures are rough estimates, and sensitive to the assumptions;

nevertheless, they illustrate the kind of peasant economy that has been taking shape, the dimensions of the transfers involved and their importance in replacing earlier support structures.

Table 2

Estimated Remittances and Transfers to the Rural Economy (average per capita inflows to the poor as a percentage of the World Bank poverty line).

Income source	Transfers as a percentage of the rural poverty line			
	1985	1990	1993	1997
THGFP	0	0	4	4
Remittances from overseas	20	21	26	30
Foodstamp programme	6	11	8	0
Janasaviya/Samurdhi programmes	0	10	9	9
Army recruitment/ compensation	5	11	13	32
TOTAL	31	53	60	75

Notes: It is assumed that the poorest 30% in the rural areas receive: 60% of all THGFP jobs; 26% of all remittances; 50% of FSP benefits; 70% of benefits from poverty alleviation programmes; and all pay from armed service employment (80% of privates or equivalent rank assumed to be from the rural poor). The figure on transfers from armed services employment takes no account of deserters. The World Bank's poverty line was Rs471 per capita per month in 1990-91 prices (World Bank 1995)

Source: Dunham and Edwards (1997: Table 10) for 1985-93. The 1997 figures were estimated by the authors using the same methodology.

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Table 2 points to a heavy and increasing dependence on remittances from Middle East employment and recruitment to the country's armed services. On a per capita basis, income to the poorest 30% of the rural population from these two sources is estimated in 1997 to have amounted to well over half the World Bank's consumption poverty line (of Rs471 per capita per month in 1990-91 prices). They also accounted for well over 10% of the total labour force — the vast majority of the workers being temporary economic migrants to the Middle East. The emerging picture is one of a fragile and highly brittle peasant economy, where poverty may have been staved off (for the moment) by transfers and remittances, but where there is no identifiable and sustainable way out of poverty.

In the more diversified Wet Zone areas, the situation was different. Some poor from these areas went to the Middle East or joined the military, but many also had other alternatives. Distinctions must be made in the plantation sector, where up-country Tamil workers had fewer options compared to many of their low-country Sinhalese counterparts, who are less hassled by security forces in towns and live nearer urban centres. Tea smallholders in Low Country areas have also benefited from soaring tea prices since late 1995. We estimate that in 1996 and 1997 an additional Rs 4.2 billion was injected into the low-country smallholder sector as a result of the high tea prices. This would have had significant employment and consumption multiplier effects in the local community, and would have benefited, *inter alia,* the rural poor - even when they were not direct recipients.[4] In 1997 alone, there was a net inflow of at least Rs 2.5 billion — equivalent to almost 30% of total government expenditure on the Samurdhi programme, to almost 30% of estimated remittances to the rural poor from war employment, and to 18% of their receipts from the Middle East.

Changing Perceptions

Even with these inflows, the situation in rural areas is in stark contrast to that of the major urban beneficiaries and to the aggressive consumerism of the urban *nouveau riche*. Their houses, cars and their lifestyles have been highly visible and they have also been increasingly resented. Political and broader social responses to growing inequalities are conditioned, not only by their magnitude, but by community perceptions of their legitimacy. And, rightly or wrongly, much of this new wealth is cynically associated in the public mind with cronyism and patronage. Even if the political will was there, the ability of a government with a slender majority to dismantle such an entrenched system of patronage was bound to be limited. Cronyism and corruption have come to be seen, not as the failing of any particular party, but as a characteristic of the system. As in all wars, questions are asked about the legitimacy of the urban rich flaunting its wealth and a luxury lifestyle when so many are being killed and maimed fighting on their behalf.

Undercurrents of concern about the legitimacy of the reform process have been further reinforced by (often well-founded) perceptions of the way it has redefined people's prospects. After 1977, English language education (almost exclusively the preserve of the urban middle class) gave access to higher-paid private sector employment. Free education has always been seen as one of the few paths to social and economic improvement for the disadvantaged. And employment in the public sector was seen almost as an entitlement by those who got it-even if was as a low-level functionary. Economic reform - by switching the 'real' benefits from Sinhala to English medium education, from public to private sector jobs and (at times) from recruitment on political to recruitment on merit criteria-was seen to have worked against the poor, and worsened (in relative terms) their long term income prospects. The jobs available to Sinhala-educated youth were primarily unskilled or semi-skilled — which they were reluctant to take and, with extensive privatisation in the 1990s, public sector employment was increasingly limited. Tamil-educated youth fared even worse.

The situation of the Tamil plantation labour force was nevertheless similar. Much has been made of the fact that consumption poverty has been found to be lowest in the plantation sector (World Bank 1995) - even if on basic health, education or child nutrition indicators it was worse. But this is very misleading: higher current incomes and consumption involve the sacrifice of long term prospects. If young people work, current household incomes are obviously higher and consumption poverty falls. But, because they then lack schooling, they are condemned to low wage jobs in the long-term. And estate youth are aware of this.

Because of these factors, low levels of absolute poverty as conventionally measured seriously understate the build up of frustrations and pressures within Sri Lankan society. This is particularly so amongst rural youth who are increasingly aware of the material benefits of a deregulated society. They are no longer content with "poor relief", with the basic standards of living of their parents or with a "rural" lifestyle. Neither they nor their families are likely to be satisfied with a system that can only offer many of them employment in the most hazardous of occupations-in the country's armed forces. The perceptions of the contrast between their prospects and those open to the urban rich magnify and exaggerate objective changes in current income inequality, creating — in Lakshman's (1997:207) terms — "volatile repositories of social discontent" in the countryside.

So What is in Prospect?

What emerges is a picture of pent-up frustrations and of severe inequality, suppressed by transfers and remittances and, more recently in the wet zone areas, by abnormally high tea prices. As long as they continued, the worst effects of rural stagnation seemed to have been successfully negotiated. However, these supports to the poor are beginning to come under pressure, and they will be vulnerable to a sharp deterioration in the economy.

And it is in this context that the bleakness of the present international scenario becomes ominous for Sri Lanka. The East Asia crisis is not over; the situation in Russia is chaotic, the Japanese economy is in slump, the US economy is slowing, and the first ripples of instability have been felt in Latin America. The global economy is delicately balanced with the possibility of a catastrophic slide to crisis. The World Bank has warned policy-makers in developing countries to prepare for an extended period of weakness and uncertainty as the crisis can no longer be treated as a brief passing phase, and developing countries as a group are more vulnerable now than at any time in recent years. Estimates of global growth in 1999 have been revised sharply downwards and the possibility of a more protracted decline, even of global recession, cannot be ruled out.

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Capital inflows have plummeted. Foreign direct investment — from East Asian economies and the Western world — has shrunk, and portfolio investment is now negligible. International investor sentiment towards the South Asian region as a whole has deteriorated further in the wake of the Indo-Pakistan nuclear explosions, further depressing the prospect of stronger private inflows. In recent years it has anyway been privatisation, rather than the setting up of new ventures, that has attracted the lion's share of foreign investment to the country.

With prospects grim on the capital account in the near term, much is going to depend on tea prices, garments exports and the level of remittances. High tea prices, continuing growth in garment exports and large remittances, together with depressed world oil prices, have underpinned the recent good news from some economic indicators. While oil prices can be expected to remain depressed, all others are in danger of erosion. With no real signs of recovery in the Russian market, large stocks, and a resurgence of Kenyan production, the outlook for the Sri Lankan tea sector is less than rosy. The garment sector has been insulated temporarily from increased competition by quotas, long term contracts, and most importantly, by the financial crisis in East Asian countries which prevented their garment suppliers exploiting the competitive advantage of depreciated currencies. The revival of liquidity to garment exporters in crisis affected countries, and the depreciation of Latin American currencies such the Mexican peso, are starting to have their impact, aggravating the disruptions caused by quota problems in the US markets. Even low oil prices have a medium term downside: depressed oil prices cut economic growth of oil producing countries and depreciate their currencies, and are bad for remittances from the Middle East. The steep devaluations that have occurred in East and South-East Asia have been eroding the export competitiveness of non-garment manufactures, already hit by depressed global prices. In combination these forces are putting strains on the exchange rate, though recent rupee-dollar movements have partially masked this because of the weakening of the dollar in international markets.

With elections looming, the probability of the war continuing and no likelihood of large-scale privatisation receipts to supplement revenues, it will be difficult for the government to rein in the budget deficit. Normal political pressures on government expenditures are strongly accentuated by the need to show success in the military arena. The fiscal position is straining under the exigencies of an intensified military effort and it faces potential revenue falls from the switch to a (non-revenue neutral) GST, lower privatisation proceeds and reduced trade tax revenues. It will find it hard to maintain the expenditure cuts of recent years, and the effects of accumulated cuts in capital expenditures (on infrastructure in particular) are bound to take their toll. The government capital budget has been slashed to dangerously low levels (to the equivalent of 5.5% of GDP in 1997), and political constraints on further cuts in consumer subsidies and state sector employment are strong. There will also be less donor aid available, especially from Japan and other East Asian countries.

An increasing fiscal deficit may begin to undermine macroeconomic stability. The depressed stock market reflects a gloomy investment climate and official forecasts suggest that the economy is slowing. As the growth rate falls, further reforms — particularly those related to fiscal consolidation — are likely to be perceived by the public as additional burdens for which there are no compensating benefits. A downturn in commodity prices, sluggishness in the garment sector and in middle-eastern employment opportunities and major budget constraints on government transfers and subsidies could have critical implications for the rural (and urban) poor.

If there is a serious downturn in the international economy, the impact will be an unavoidable aggravation of all these already serious problems: markets will be lost; commodity prices will slide, and productive foreign investment will become even harder to attract. And, if it occurs, it will be at a time when there is disenchantment with mainstream politics and mounting concern about the human cost of the war. International experience suggests that, in protracted civil wars, war employment comes to be seen, not as a noble gesture (for the country or to assure income for the family), but as a sacrifice to preserve the lifestyles of the rich and the privileged. Security is interpreted in a narrow sense — as the security of the state, state buildings, economic targets and major political figures. But this is not necessarily the same as security for all individuals. Senior police officials have maintained that high security tasks have left insufficient numbers to cope with an escalation of crime and violence affecting everyday life.[5]

This is a potentially volatile situation. The high level of suicides (and attempted suicides), large-scale military desertions, and desperate attempts to escape from the country (either legally or illegally) reflect a crisis of confidence in the social and political order. Even the near-hysteria and wild swings in mood (from euphoria to mass depression) that accompany success and failure of the national cricket team are in a way a reflection of the new role of one-day cricket as the modern "opium of the people". But the seeds are there for a more violent response by rural youth, many of whom now have military experience and some of whom have deserted with their weapons.

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And if outbursts do materialise, the situation will differ in important ways from the violent youth uprisings in 1971 and 1987-89. In both the earlier cases, broad mass support was lacking. If there is a collapse in the living standards of the poor, it could exacerbate their disenchantment with mainstream politics. And now, unlike earlier, there are large numbers of disaffected rural youth trained and experienced in the use of weapons, and in some cases possessing them.

Strident assertions that "despite these developments — all is well", widen the credibility gap in society. The articulate urban-elite that sets the tone in policy seems to have insulated itself from the everyday struggles, insecurity, bereavement and trauma of the poor, the displaced and the marginalised rural youth. That they see no storm clouds on their horizons is in itself partly a reflection of this disarticulation in Sri Lankan society. But whether they are seen or not, the storm clouds are unlikely to disappear.

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(Note: The views expressed in this essay are those of the authors and not of any institution).

Notes

1. The fiscal deficit narrowed significantly, total public debt (as a share of GDP) fell, inflation and interest rates came down, national savings increased, the current account and the external debt situation improved, and a healthy level of foreign reserves was maintained. By and large, these macroeconomic indicators were still healthy in the first half of 1998.

1a. The Gini coefficient is widely used as a measure of inequality in distributions. It takes values between zero (perfectly equal distribution) and one (completeconcentration in a single unit).

2. The 1973 figure is not crucial to our argument. It suggests a sharp improvement in income equality, but there has been much debate about its accuracy (see Lee 1997; Isenman 1980; Lakshman 1980). There is general consensus that income distribution improved during the decade from the early 1960s to the early '70s, but the extent of the improvement is highly debatable.

3. On this there is little controversy (see for example the World Bank 1995). However, little attention has been paid to the relative scale of these transfers and their vulnerability.

4. The volume of output also increased 13% (Central Bank 1998a). The rural population inthe area was approximately 5 million. The net inflow is defined as the net sale average per kilogram made tea minus the cost of production multiplied by the output. It is assumed, on the basis of figures from the ministry of Plantations, that 64% of low Country tea was in the smallerholder sector.

5. See the interview with Deputy Inspector General of Police M.H.Kotakadeniya, in charge of the Criminal Intelligence and Police Security Division, reported in the *The Island* Saturday 17 October 1998.